No. 14,204

In the United States Court of Appeals for the Ninth Circuit

JAMES M. FIDLER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

H. BRIAN HOLLAND,
Assistant Attorney General.

ELLIS N. SLACK,
HILBERT P. ZARKY,
DAVIS W. MORTON, JR.,
Special Assistants to the Attorney General.

INDEX

CITATIONS

Cases:

Statutes:

Internal Revenue Code:

In the United States Court of Appeals
for the Ninth Circuit

No. 14,204

JAMES M. FIDLER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 122-150) are reported at 20 T.C. No. 149.

JURISDICTION

This case involves individual income tax deficiencies of $7,316.60 for the calendar year 1944 (R. 17), of $10,293.79 for the calendar year 1945 (R. 19), and of $6,992.74 for the calendar year 1946 (R. 20). Notice of the deficiencies was mailed to taxpayer on January 31, 1950. (R. 14-15.) On April 26, 1950 (R. 3), within the permitted 90-day period, taxpayer filed a petition for review with the Tax Court for a redetermination of the

deficiencies under the provisions of Section 272 of the Internal Revenue Code (R. 6-13). The Commissioner filed an answer (R. 21-22) and a hearing was held on February 5, 1952 (R. 23-59). The decision of the Tax Court sustaining the deficiencies was entered on September 29, 1953. (R. 150-151.) Petition for review by this Court was filed on December 18, 1953. (R. 151-153.) This Court accordingly has jurisdiction of the case under the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Whether, within the meaning of Sections 22(k) and 23(u) of the Internal Revenue Code, the Commissioner properly disallowed, as "installment payments," deductions of $7,200, $9,600, and $9,600, claimed, respectively, as "periodic payments" made to taxpayer's divorced spouse during the calendar years 1944, 1945 and 1946.

2. Whether, within the meaning of Sections 23 and 117 of the Internal Revenue Code, the Commissioner properly treated as a long term capital loss a claimed deduction of $4,750, which taxpayer had treated in his 1945 income tax return as an ordinary loss arising on an alleged sale of certain books and manuscripts.

STATUTES INVOLVED

The pertinent statutes are set forth in the Appendix, *infra.*

STATEMENT

The facts giving rise to the legal issues here presented, including the stipulation (R. 59-64), exhibits (R. 65-110), and supplemental stipulation and exhibits (R. 111-

122) which were incorporated therein by reference (R. 124), are set forth in the Tax Court's findings of fact (R. 124-140) and appear as follows:

Taxpayer is a resident of Los Angeles, California. He filed his income tax returns for the calendar years 1944, 1945 and 1946 with the Collector of Internal Revenue for the Sixth District of California at Los Angeles. (R. 124-125.)

In 1936 taxpayer was married to Ruth Law Fidler, sometimes known as Roberta Law Fidler and Roberta L. Fidler (hereinafter referred to as "Ruth Fidler"). (R. 125.)

There was no issue of this marriage, and in 1942 taxpayer and Ruth Fidler adopted a newly-born baby girl. (R. 125.)

Thereafter, taxpayer and Ruth Fidler became separated, and on August 20, 1943, they entered into a written agreement which provided, among other things, that taxpayer should have the exclusive custody and control of the minor child, subject to Ruth Fidler's right to reasonable visitation; that upon the execution of the agreement, Ruth Fidler should receive, as her share and in full division of the property of the parties, a certain Packard automobile and $20,000 in cash or securities; and that, in addition thereto, taxpayer would pay to Ruth Fidler, in full and final payment for her support, maintenance and alimony, the sum of $30,000 in monthly installments of $500 per month, commencing on September 1, 1943. Taxpayer's obligation to make such payments at the rate of $500 per month to Ruth Fidler for her support and maintenance was evidenced by two promissory notes executed by taxpayer and delivered to

her, concurrently with the execution of the agreement, and the terms of the notes were set forth in full in the agreement. One of the notes provided for the payment to Ruth Fidler of the sum of $18,000, payable in consecutive, monthly installments of $500 per month commencing on September 1, 1943. The second note provided for the payment of the sum of $12,000, payable in consecutive, monthly installments of $500 per month, commencing on October 1, 1946. Each note contained a provision that in the event taxpayer defaulted in the payment of any installment when due, the whole note might become immediately due and payable at the option of Ruth Fidler or the holder thereof, and that should suit be commenced to enforce payment of the note, taxpayer would pay such additional sums as attorney's fees as the court might adjudge to be reasonable. (R. 125-126.) The $12,000 note, only, contained the following additional provision (R. 126):

> This promissory note is given by the undersigned to the payee in accordance with an Agreement executed by and between the parties this date, for the support and maintenance of the payee. This note shall become absolutely void and of no effect upon any remarriage of the payee and whether or not such remarriage shall be valid.

The agreement of August 20, 1943, was prepared by a firm of Los Angeles attorneys who represented Ruth Fidler. (R. 126.)

On October 21, 1943, an amendment to the agreement of August 20th was executed by taxpayer and Ruth Fidler, the effect of which was to eliminate the provision above quoted appearing in the $12,000 note, and Ruth Fidler acknowledged receipt of the $12,000

note, as thus amended, and also the $18,000 note above referred to. (R. 126-127.)

On December 16, 1943, the agreement was again supplemented and amended to provide, in effect, that Ruth Fidler should have exclusive custody and control of the minor child of the parties for a period of six months during each year and that taxpayer should have the exclusive custody and control of the child for a like period of six months during each year; and that during such times as Ruth Fidler should have the custody and control of the child taxpayer would pay the costs of a nurse, food, clothing and medical expense for the child. (R. 127.)

On February 4, 1944, the taxpayer and Ruth Fidler entered into a new agreement, which superseded their previous agreements. This new agreement also made provision for the custody and support of the minor child of the parties, and settled all rights and claims in respect of property and support between the parties. It, in substance, provided among other things that each of the parties should have the exclusive custody and control of their minor child for six months during each year, and that taxpayer would pay to Ruth Fidler for the care, support and maintenance of the child during the period that she should have its custody and control the sum of $200 per month as well as any extraordinary medical care and attention required for the child; that in addition to the Packard automobile and $20,000 in cash or securities theretofore transferred by the taxpayer to Ruth Fidler as her share of and in full division of the property of the parties, taxpayer agreed to and did transfer to her an additional sum of $7,000 in cash or securities. (R. 127-128.) In addition to the foregoing, and with respect to alimony, support and main-

tenance for Ruth Fidler, the agreement provided as follows (R. 128):

> Seventh: In addition to the foregoing, and on account of full and final payment of maintenance and support, alimony and alimony pendente lite to Second Party, and counsel fees and costs in any pending or future action between the parties hereto, First Party does hereby redeliver to Second Party, and Second Party will retain, those two (2) certain promissory notes, being the same notes described in Paragraph First of Amendment to Agreement of August 20, 1943, in words and figures as follows, to-wit: * * *

After setting forth, verbatim, the terms of the two promissory notes hereinabove referred to, as amended on October 21, 1943, the agreement goes on to provide for additional payments in the form of a third promissory note as follows (R. 128-131):

> In addition to the foregoing and in full and final payment of maintenance and support, alimony and alimony pendente lite to Second Party, and counsel fees and costs in any pending or future action between the parties hereto, First Party will, upon the execution of the within instrument, make, execute and deliver unto Second Party one (1) promissory note, in words and figures as follows, to-wit: $16,200.00.
>
> Los Angeles, California
> February 4, 1944.
>
> At the time stated after date, for value received, I promise to pay to Roberta L. Fidler, only at Los Angeles, California, the sum of Sixteen Thousand

Two Hundred ($16,200.00) Dollars, without interest. Principal payable in lawful money of the United States. This note is payable in installments of Three Hundred ($300.00) Dollars each month, payable upon the first day of each and every calendar month subsequent to the first day of March, 1944, and any default in the payment of any installment when due shall cause the whole note to become immediately due and payable at the option of said Roberta L. Fidler. Should suit be commenced to enforce the payment of this note, I agree to pay such additional sum as the Court may adjudge reasonable as attorney's fees in said suit. Demand, presentment for payment, protest and notice of protest are hereby waived.

This promissory note is given by the undersigned to the payee in accordance with an Agreement executed by and between the parties this date, on account of the support and maintenance of the payee. Should payor, at any time during the term hereof, not have a radio contract under the terms of which he receives a monthly sum equal to the monthly sum he is now receiving under his present radio contract, the monthly installments falling due hereunder during said periods shall be reduced in proportion to the amount of the reduction of his present radio contract, and should payor have no radio contract at all, then all monthly installments falling due hereunder during said period, shall be waived by payee, and payor shall not be required at any future time to pay the balance of any reduced, or waived payments, hereunder.

(S.) James M. Fidler,
4362 Clybourne Avenue,
Burbank, California.

That Second Party accepts said three (3) promissory notes, for her support and maintenance and not in lieu of property rights, upon the following conditions:

(a) In lieu of other provisions for the support and maintenance of Second Party during her natural life;

(b) In full payment, discharge and satisfaction of all obligation or any thereof, on the part of First Party to maintain or support Second Party during her natural life;

(c) In full payment, discharge and satisfaction of counsel fees and costs in any pending or future action between the parties hereto, other than an action on said or any of said promissory notes.

Eighth: That the installment payments provided in the three (3) promissory notes hereinabove set forth, being taxable to her as income, Second Party will, from and after the date hereof, file such income and tax returns and/or declarations, both Federal and State, as are required by law, and will include therein all such support and maintenance payments received by her, and will pay all taxes shown to be due and payable under such returns and/or declarations.

Should any of the monthly installments provided for in the said $16,200.00 promissory note, last above described, be reduced or waived and the payor not be required to make same, First Party will give to Second Party, not for her support and maintenance, but as an absolute gift without condition, sufficient moneys to enable Second Party to pay her income taxes, both Federal and State, when due, on support and maintenance payments re-

ceived from First Party, but not on income received by Second Party in excess thereof, without resort to the support and maintenance payments provided for in the two other promissory notes, above described, it being the intention of the parties hereto that Second Party will, during any period that the payments under said promissory note last above described are reduced or waived, have a net minimum sum of $500 per month for her support and maintenance.

In the preparation and execution of the agreement of February 4, 1944, taxpayer and Ruth Fidler were each represented by attorneys of Los Angeles, California. (R. 132.)

At the time of the execution of the agreement and for several years prior thereto, taxpayer's principal business or occupation was that of radio commentator and newspaper columnist. (R. 132.)

The "present radio contract" referred to in the agreement of February 4, 1944 (and in the amended decree of divorce hereinafter referred to), was a contract which was in force on February 4, 1944, and March 20, 1944, between taxpayer and the sponsor of a weekly radio broadcast program under which taxpayer was engaged to render his services as a commentator and reporter on the weekly radio program. The term of the radio contract was 26 weeks. The sponsor, however, had the option to renew and extend the contract of employment for additional, successive terms of 26 weeks' duration. (R. 132.)

In 1944 Ruth Fidler, as plaintiff, instituted an action in the District Court of the State of Nevada in the County of White Pine against taxpayer, as defendant, wherein she prayed that she be granted a divorce from

taxpayer and that the agreement of settlement and separation of February 4, 1944, be approved by the court. (R. 132.)

Ruth Fidler was represented in the action by a firm of attorneys of Las Vegas, Nevada. (R. 132.)

Taxpayer never personally appeared in the Nevada divorce action, but authorized an attorney of Ely, Nevada, to appear for him. (R. 132.)

The divorce action was tried at Ely, Nevada, on March 20, 1944, and a decree of divorce was rendered in favor of Ruth Fidler against taxpayer. (R. 133.)

The formal decree of divorce as signed by the judge of the court adjudged and ordered as follows (R. 133-134):

> Now, Therefore, it is hereby Ordered, Adjudged and Decreed that the marriage relationship now and heretofore existing between plaintiff and defendant be and the same is hereby dissolved and the parties are restored to the status of single persons.
>
> It Is Further Ordered, Adjudged and Decreed that that certain Settlement Agreement entered into between the parties, dated February 4, 1944, be and the same is hereby confirmed, ratified, approved and adopted as a part of this Decree.
>
> It Is Further Ordered, Adjudged and Decreed that the defendant herein have the care, custody and control of the minor child, named Bobbe Fidler, Jr., until October 1, 1944, and thereafter the plaintiff is to have the custody of the child for the next ensuing six months, or until April 1, 1945, thereafter the custody of said child shall be distributed to the parties for six months each, until further order of this Court; that during the term plaintiff has custody of the said minor child, defendant shall pay to her for the care, support and maintenance

of said child, the sum of Two Hundred ($200.00) Dollars per month.

It Is Further Ordered, Adjudged and Decreed that the defendant shall pay to the plaintiff, in accordance with the terms of said Settlement Agreement, the sum of Eight Hundred ($800.00) Dollars per month, commencing forthwith and continuing for a period of five years.

The Court herewith retains jurisdiction herein with reference to the said minor child for the purpose of making such orders as may hereafter appear to best serve the interest of said minor child.

Dated and Done this 20th day of March, 1944.

HARRY M. WATSON,
District Judge.

The decree was inconsistent and ambiguous, in that while it "confirmed, ratified, approved and adopted as a part" of it the settlement agreement entered into between taxpayer and Ruth Fidler on February 4, 1944, and ordered taxpayer to make payments to Ruth Fidler "in accordance with the terms of said Settlement Agreement," it also provided that such payments should be "the sum of Eight Hundred ($800.00) Dollars per month, commencing forthwith and continuing for a period of five years." (R. 134.)

When the Los Angeles attorney who had represented taxpayer in the preparation of the settlement agreement of February 4, 1944, received a copy of the above decree, he immediately noted the inconsistency of its provisions, and communicated with Ruth Fidler's attorneys in Las Vegas, Nevada, concerning it, and suggested that the decree be amended to reflect correctly the terms of the settlement agreement. (R. 134.)

The inconsistency in the decree was due to inadvertence, and Ruth Fidler's attorneys agreed that the decree should be amended. A form of amended decree was prepared, and on September 11, 1944, Ruth Fidler's attorneys sent such form of amended decree to the attorney at Ely, Nevada, who had appeared for taxpayer in the divorce action, and requested him to present the proposed amended decree to the court. (R. 134-135.)

Thereafter, on September 18, 1944, upon application of the attorney, the court ordered that the decree of divorce be amended to recite correctly the terms and provisions of the agreement of settlement between taxpayer and Ruth Fidler. (R. 135.)

An amended decree, as filed on November 16, 1944, contained the exact terms and language as set forth in the original decree above-quoted except that the following paragraph was deleted (R. 135):

> It Is Further Ordered, Adjudged and Decreed that the defendant shall pay to the plaintiff, in accordance with the terms of said Settlement Agreement, the sum of Eight Hundred ($800.00) Dollars per month, commencing forthwith and continuing for a period of five years.

In lieu thereof the following paragraphs were substituted (R. 135-137):

> It is Further Ordered, Adjudged and Decreed, that defendant shall pay to plaintiff in accordance with the terms of said Settlement agreement the sum of Eight Hundred ($800.00) Dollars per month commencing forthwith and continuing for a period of four years and five months, the last monthly payment becoming due and payable on August 1, 1948, providing, however, that should

defendant, at any time before August 1, 1948, not have a radio contract under the terms of which he received a monthly sum equal to the monthly sum he is now receiving under his present radio contract, monthly payments to the extent of the sum of Three Hundred ($300.00) Dollars of said sum of Eight Hundred ($800.00) Dollars per month, shall be reduced in proportion to the amount of the reduction of his present radio contract and should defendant have no radio contract at all, between the date hereof and said August 1, 1948, then monthly payments to the extent of the sum of Three Hundred ($300.00) Dollars per month of said sum of Eight Hundred ($800.00) Dollars per month, shall be waived and shall not be made to plaintiff by defendant, and defendant shall not be required at any future time to pay to plaintiff the balance of any reduced, or waived, payments hereunder.

It Is Further Ordered, Adjudged and Decreed, that all executory provisions of said Settlement Agreement which are not incorporated in this Decree in a plenary manner, are hereby declared to be binding on the respective parties hereto, and each of said parties is hereby ordered to do and perform all acts and obligations required to be done or performed by said executory provisions of said Settlement Agreement.

The amended decree was dated and signed by the same judge who had tried the divorce action and signed the original decree, in the following fashion (R. 137):

Dated and Done this 20th day of March, 1944.

/s/ Harry M. Watson,
District Judge.

On and prior to March 20, 1944, taxpayer had paid and transferred to Ruth Fidler all moneys and properties due to her under the terms of the settlement agreement of February 4, 1944, had paid certain sums required to be paid to her attorneys for representing her, and had made all payments to her which had then become due and payable to her pursuant to the terms of the promissory notes referred to and described in the agreement. After March 20, 1944, and during the years 1944, 1945 and 1946, taxpayer also paid Ruth Fidler all sums which he was obligated to pay to her under the terms of the settlement agreement and the decree of divorce for the care, support and maintenance of the minor child of the parties. In addition to the foregoing, taxpayer, pursuant to the terms of the agreement and decree, paid to Ruth Fidler as alimony and for her support and maintenance the sum of $800 each month during the period commencing April 1, 1944, and ending December 31, 1946. (R. 137-138.)

The divorce decree as amended remained in full force and effect during the years 1945 and 1946. (R. 138.)

During the period from February 4, 1944, to December 31, 1946, the sponsor of the weekly radio broadcast program hereinbefore referred to, to whom taxpayer was under contract on February 4, and March 20, 1944, exercised its option to renew and extend the contract with the result that taxpayer was continuously employed by this sponsor during this period and received, under the contract and the renewals and extensions thereof, monthly compensation equal to the monthly compensation which he had been receiving under the radio contract on February 4 and March 20, 1944. (R. 138.)

On his income tax return for the calendar year 1944, taxpayer claimed deductions in the sum of $9,000 by reason of alimony payments made to Ruth Fidler during that year. Of this sum, $1,800 was paid by taxpayer prior to the rendition of the decree of divorce on March 20, 1944, and at the trial of this proceeding, taxpayer conceded that such sums aggregating $1,800 paid prior to the decree of divorce would not be properly deductible by him. (R. 138.)

In his income tax returns for the calendar years 1945 and 1946 taxpayer claimed deductions in each year in the sum of $9,600 by reason of the alimony payments made to Ruth Fidler during those years. (R. 138.)

The Commissioner, in his notice of deficiency, disallowed the deductions claimed in each year upon the ground that "said amounts do not qualify as proper deductions under the provisions of section 23(u) of the Internal Revenue Code." (R. 139.)

In the year 1937, taxpayer acquired by assignment and transfer from William N. Selig a stock of literary properties consisting of all of Selig's property rights, of every kind and nature, in approximately seventy-five published novels and stage plays, and approximately 2,000 original manuscripts, scenarios, and motion picture shooting scripts. Taxpayer paid Selig $5,000 for these properties. (R. 139.)

A Mr. Bentel, who was a literary agent and friend of taxpayer, induced taxpayer to buy the literary properties. Bentel advised taxpayer that Selig was in failing health and was willing to sell these properties at what Bentel considered to be a reasonable price because among them were some properties which Bentel believed were quite good and which might be sold to motion picture studios at a profit. (R. 139.)

Taxpayer had an oral understanding with Bentel that Bentel would conduct a campaign to sell the stories, books, or plays, and that after taxpayer recouped his $5,000 investment from such sales, he and Bentel would thereafter divide the returns on a "fifty-fifty" basis. (R. 139.)

After the literary properties were acquired, a tabulation was made of them, and they were placed on display in the offices of Bentel. (R. 140.)

Taxpayer purchased the literary properties with the intention of attempting to sell some of them at a profit. They were not purchased for use in his work as a commentator or columnist, and none of them was ever used in such work. No sale of any of the literary properties was consummated prior to 1945, although at one time taxpayer and Bentel thought a studio was going to purchase a book entitled "Under Two Flags." In 1945, taxpayer sold all of the literary properties acquired from Selig for $250, to Eric Ergenbright, who was, and had been, an employee of taxpayer for many years. (R. 140.)

In his income tax return for the year 1945, taxpayer claimed a deduction in the amount of $4,750 as an ordinary loss. In determining the deficiency the Commissioner disallowed the claimed deduction stating that the "ordinary loss claimed of $4,750.00 from sale of Selig Library of books and manuscripts has been determined to be a loss from the sale of capital assets held for more than six months and subject to the provisions of section 117 (b) and (d) of the Internal Revenue Code." (R. 140.)

SUMMARY OF ARGUMENT

1. Where, pursuant to a decree of divorce or a written instrument incident to a decree of divorce, a hus-

band is obligated to pay a principal sum of money to the divorced spouse and such sum is payable in installments over a period of less than 10 years, the payments received by the wife are not taxable income to her and such payments are not deductible by the husband.

In the present case, the taxpayer-husband was obligated to make payments of $500 per month over a 53-month period. The discharge of this obligation was not subject to any conditions. Accordingly, the Tax Court was correct in holding that these payments were not deductible by the taxpayer.

The taxpayer was also obligated to make additional payments of $300 per month to his divorced wife, but this obligation was conditioned on the taxpayer's having an employment contract of the same kind which he had when the divorce was entered. If this contract were not renewed, the obligation to pay $300 per month would cease, and if the contract paid him less money, this obligation would be proportionately reduced. While we believe the Tax Court was correct in holding that this additional payment was also not deductible even though it was subject to contingencies which never occurred, we recognize that this Court's decision in *Myers* v. *Commissioner* would, if adhered to, require a contrary result in this case if this Court should also conclude that the contingencies here are not substantially different than those present in the *Myers* case.

Whatever may be the decision with respect to the payments of $300 per month which were subject to a contingency, there is no merit in the taxpayer's contention that this contingency should permit the taxpayer to deduct the full $800 per month which he paid his wife. The payment of $500 per month was unconditional and

represented a minimum, principal sum which the taxpayer was obligated to pay in installments. Such payments are nondeductible under the statute.

2. The Tax Court correctly held that, upon the evidence here presented by taxpayer, the loss of $4,750 sustained on taxpayer's sale to an employee in 1945 of certain books and manuscripts purchased in 1937 constituted a long-term capital loss arising on the sale of "capital assets", within the meaning of Sections 23(e), (g) and 117 of the Internal Revenue Code. In this connection, it is apparent from the record that taxpayer's only business or occupation in which he was engaged was that of a radio commentator and newspaper columnist. Neither was he engaged in any other trade or business, as was clearly shown by his testimony reflecting his lack of activity with respect to these literary materials coupled with the absence of any sales of the more than 2,000 items over a period of eight years. Nor was any proof submitted that these properties were excludable from the category of "capital assets" as constituting a stock in trade or property of a kind that would properly be included in inventory, or property held primarily for sale to customers in the ordinary course of trade or business, within the meaning of Sections 22(c) and 117(a)(1) of the Internal Revenue Code. Instead, the record substantiates the Tax Court's holding that the taxpayer purchased these literary properties as an investment in the expectation of selling them at a profit, held them for more than six months, and, upon ultimate sale at a loss, the loss sustained was properly a long-term capital loss within the provisions of Section 117(a)(1), (b) and (d) of the Internal Revenue Code.

ARGUMENT

I

The Tax Court Correctly Held That, Under the Facts Here Obtaining, the Alimony Payments Made by Taxpayer During the Period April 1, 1944, to December 31, 1946, Constituted Non-deductible "Installment Payments" and Not Deductible "Periodic Payments", Within the Meaning of Sections 22(k) and 23(u) of the Internal Revenue Code

1. Section 23(u) of the Internal Revenue Code (Appendix, *infra*) permits a husband, "described in section 22(k)", to deduct, in computing net income, alimony "includible under section 22(k) in the gross income of his wife, payment of which is made within the husband's taxable year."

With respect to the inclusion of alimony in the gross income of the recipient wife, Section 22(k) of the Internal Revenue Code (Appendix, *infra*), insofar as here pertinent, provides that she include only "periodic payments" received under circumstances, as follows:

> SEC. 22. GROSS INCOME.
>
> * * * * *
>
> (k) *Alimony, Etc., Income.*—In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, *periodic payments* * * * received subsequent to such decree in discharge of, * * * a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, * * *. [Italics supplied.]

In other words, unless alimony payments to a divorced wife are properly deemed taxable to her as "periodic payments", the payor husband cannot be permitted the deduction provided under the terms of Section 23(u). In describing the legal characteristics of non-deductible payments made by a husband to his divorced wife for her support and maintenance or for alimony, Section 22(k) of the Code provides:

> *Installment payments* discharging a part of an *obligation* the principal sum of which is, in terms of money or property, specified in the decree or instrument shall *not* be considered periodic payments for the purposes of this subsection; * * *. [Italics supplied.]

In other words, when the obligation to the divorced wife is to pay a sum of money, the husband is not entitled to any deduction even though the obligation is not to be paid at one time and is to be discharged by "installment payments" within a period of less than 10 years. It makes no difference whether the agreement or the decree recites the ultimate sum of money which is to be paid in installments, or whether the obligation merely refers to the installments to be paid (which can, of course, readily be added up to ascertain the principal sum which constitutes the husband's obligation). In both situations a "principal sum" is being paid by the husband and in neither situation is the husband entitled to a deduction under the express statutory provisions. *Herbert* v. *Riddell,* 103 F. Supp. 369 (S.D. Cal.). Any other rule would lead to the absurd result under which the tax consequences as between the parties would turn on whether the agreement or decree has added up

or failed to add up to the ultimate sum which is to be paid to the wife in installments. We submit, on the contrary, that in drawing the distinction between "installment payments" and "periodic payments" in Section 22 (k), Congress never intended that the same essential payments should fall in one category or the other dependent only upon whether there has been an arithmetic computation in the decree or the agreement adding up the definite and unconditional payments which the husband is required to make to his divorced wife.

In the present case, under the amended divorce decree, which expressly "adopted" the settlement agreement of February 4, 1944 (R. 108), the taxpayer was obligated to make $800 monthly payments consisting of two separate components of $500 (R. 71-73) and $300 (R. 73-74). The $500 monthly payments were to be made for a definite period of time, i.e., until August 1, 1948, they were not to cease in the event of the husband's death, the wife's death, or the wife's remarriage, and were not subject to any other contingency. Consequently, although the agreement of the parties and the divorce decree did not state the ultimate amount payable, the taxpayer had a simple, unconditional obligation to pay his wife a total of $26,500 through monthly payments of $500 extending over a 53-month period. This, we maintain, is the clearest kind of "principal sum" dischargeable by "installment payments" which Section 22 (k) provides should not be deducted by the husband. The denial of the deduction to the husband is just as clearly required by the statute in the circumstances of this case as would have been true if the agreement or the decree had multiplied the $500 payments by

53 and had stated that the total to be paid equalled $26,500. See *Herbert* v. *Riddell, supra.*

2. The taxpayer was also obligated to make additional payments of $300 per month to his wife during the 53-month period contingent on the taxpayer's having a radio contract paying him the same amount which he was then earning under an existing contract. If the taxpayer were to have no radio contract during that period, he was not obligated to pay her the $300 per month or, if he had a contract paying less money than he was currently receiving, he was only obligated to pay a proportionate part of the $300 per month. (R. 135-137.) Notwithstanding that this part of the taxpayer's obligation was subject to the above described contingencies, the Tax Court held that the obligation to pay $300 per month was also an installment obligation not deductible by the taxpayer. In *Baker* v. *Commissioner,* 205 F. 2d 369 (C.A. 2d), the Court of Appeals reversed the Tax Court and held that where the payments were to cease if the wife remarried, there was a contingency sufficiently incalculable to prevent the overall obligation from being described as a "principal sum". In the present case, the Tax Court respectfully declined to follow the *Baker* decision and decided to adhere to its own contrary precedents. (R. 145-146.)

Subsequent to the decision below, the Court of Appeals for the Third Circuit in *Smith's Estate* v. *Commissioner,* 208 F. 2d 349, also held that there was no "principal sum" where the husband's obligations were to cease if he were to die, if the wife were to die, or if she were to remarry. This Court, in its recent decision in *Myers* v. *Commissioner,* decided May 10, 1954, re-

versed the Tax Court and held that the payments were deductible by the husband where, as the taxpayer contended, the husband's obligation would cease upon the wife's remarriage or on the death of either party. We believe, for the reasons set forth in the Government's brief in the *Myers* case, that the Tax Court's position in that case, in this case, and in other similar cases constitutes a proper application of the statutory standard. However, if this Court should adhere to its decision in the *Myers* case, and if it should determine that there are no cogent distinctions between the contingencies present in the *Myers* case and that present here, we believe that the Tax Court's decision is at variance with *Myers* to the extent that it relates to the payments of $300 per month.

3. The taxpayer claims that, because of the possible contingency affecting the payments of $300 per month, he should be entitled to deduct the full $800 per month payments which were made during the taxable period. The argument seems to be that there was a single obligation to pay $800 per month and that, because of the contingencies affecting the $300 payments, no part of the entire $800 payments can be described as "installment payments" of a "principal sum".

Even if we could assume, *arguendo,* that the taxpayer had a single obligation to pay $800 per month, the unalterable fact remains that part of that obligation, namely, $500 per month, was subject to no contingency and that the taxpayer did have an obligation to pay a minimum "principal sum" of $26,500 in 53 monthly payments of $500 each. That amount, being definite and certain, being subject to no contingencies, and being payable in less than a 10 year period, is not taxable to

the divorced wife and is not deductible by the taxpayer-husband.

We dispute, moreover, the taxpayer's primary assumption that there was but a single obligation to pay $800 per month. As the Tax Court carefully pointed out (R. 142-144) the undisputed facts clearly show that the taxpayer's ultimate obligation of paying $800 per month consisted of two separate components, one to pay $500 per month unconditionally, and the other to pay $300 per month subject to the conditions previously described. The separate aspects of this obligation were consistently recognized by the parties and the divorce court also differentiated the payments to be made.

The amended agreement of the parties (Joint Ex. 1-A, R. 65-85) and the notes executed by the taxpayer pursuant to the agreement (R. 71-74) set forth and specifically recognize that taxpayer had two distinct and different undertakings. One, represented by two notes of $18,000 and $12,000, respectively, was an unqualified obligation to pay $500 per month during the period specified. The other, represented by a note of $16,200, embraced the obligation to pay $300 per month subject to the contingencies already described. It is most significant that when the original divorce decree (R. 105) provided that the taxpayer should pay his divorced wife $800 per month "in accordance with the terms of said Settlement Agreement", the parties considered that there was a possible inconsistency between their agreement and the decree and obtained an amended decree (Exs. 5-12, R. 113-122). The amended decree (Joint Ex. 3-C, R. 107-109) made it exceedingly clear that out of the payments of $800 per month, $500 was absolutely owing and $300 was conditional. We do not know how

the divorce decree could have contained any clearer provisions demonstrating that the taxpayer would be required to pay a principal sum of not less than $26,500 in monthly installments of $500 over the specified, remaining period, i.e., four years and five months.

II

The Tax Court Correctly Held That the Taxpayer Sustained a Long-term Capital Loss on the Sale of Certain Books and Manuscripts

The remaining issue relates to the loss of $4,750 sustained by taxpayer in 1945 upon the sale of books and manuscripts he acquired from one Selig for $5,000 in 1937. (R. 139.)

Taxpayer contends that the Commissioner erred in treating such loss as a long-term capital loss from the sale or exchange of "capital assets"; that the literary properties sold fell within those types of property which are expressly excluded from "capital assets" in Section 117(a)(1) of the Internal Revenue Code (Appendix, *infra*), i.e., "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business"; and that the loss was an ordinary business loss deductible in full under the provisions of Section 23(e) (Appendix, *infra*).

The Commissioner submits that the Tax Court properly held the literary properties here in question constituted capital assets within the meaning of Section 117(a)(1) of the Internal Revenue Code, and that the loss sustained was, accordingly, a long-term capital

loss, subject to the provisions of Section 117(b) and (d) of the Coode. (Appendix, *infra.*)

Section 23(e) provides that individual taxpayers shall be allowed as deductions losses sustained during the taxable year (1) if incurred in trade or business; or (2) if incurred in any transaction entered into for profit, though not connected with trade or business. Section 23 (g) (Appendix, *infra*) provides that losses from sales of capital assets shall be allowed only to the extent provided in Section 117. Losses from the sale of capital assets held for more than six months are deductible only to the extent of $1,000 under Code Section 117 (d).

Here, taxpayer bought the literary properties in question from Selig in 1937, held them for eight years, and sold them in 1945. During the eight year period he never consummated a single sale (R. 39) of any of them, although they comprised more than 2,000 items (R. 139). While he testified that he and Bentel made efforts to sell various books and stories to some of the motion picture studios (R. 38), when asked on cross-examination to name some of the prospects approached regarding their sale, he replied (R. 50-51, 148):

> I don't know that I could specify with stories, to which studios. There were several stories involved, several books involved, and some of them were hot and some were cold. One in particular that was hot, that we thought was sold, was a book called "Under Two Flags." I believe that was the title.
>
> The book called "Under Two Flags," Mr. Bentel and I both believed that the sale—and I think the sale was to have been to RKO, we both believed the sale was in the bag. About that time another studio made a motion picture, which they titled

"Under Two Flags," and it kayoed, or whatever you want to call it—it stopped our sale.

The Commissioner submits that the Tax Court correctly held, on the basis of the record here presented, that taxpayer's only business or occupation was that of a radio commentator and newspaper columnist, that the taxpayer was not in the business of selling literary material, and that the items in question were not his stock in trade and were not being held primarily for sale to customers. (R. 50.)

While it is obvious that an individual may engage in more than one business, taxpayer here has not established that he did so. He made an investment in the literary properties with the hope or expectation of selling them at a profit. This hope or expectation was never realized from 1937 to 1945. The only sale of any of these properties was the one made in 1945 to one Ergenbright, one of his employees. (R. 53.) While he may have held the properties for sale, it was not "primarily for sale to customers in the ordinary course of his trade or business," within the meaning of Section 117 (a)(1) of the Internal Revenue Code. He did not or could not prove any activity from which the Tax Court or this Court could find that he was engaged in a trade or business with respect to the literary properties. Neither did he show that these properties constituted stock in trade or property of a kind which would properly be included in inventory.

This Court has frequently ruled that the kind of question here presented is essentially one of fact for resolution by the Tax Court. *Richards* v. *Commissioner,* 81 F. 2d 369, 370; *Field* v. *Commissioner,* 180 F. 2d 170; *Rubino* v. *Commissioner,* 186 F. 2d 304, cer-

tiorari denied, 342 U. S. 814; *Rollingwood Corp.* v. *Commissioner,* 190 F. 2d 263, 265. There has been no demonstration that the Tax Court failed to apply the proper legal standards or that it failed to appraise all the evidence. Well established principles require that its decision should be affirmed.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
HILBERT P. ZARKY,
DAVIS W. MORTON, JR.,
Special Assistants to the Attorney General.

MAY, 1954.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

* * * * *

(c) *Inventories.*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

* * * * *

(k) [As added by Sec. 120(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Alimony, Etc., Income.*—In the case of a wife who is divorced or legally separated from her husband under a decree or divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, and such amounts received as are attributable to property so transferred shall not be includible in the gross income of such husband. This subsection shall not apply to that part of any such periodic payment which the terms of the decree or written

instrument fix, in terms of an amount of money or a portion of the payment, as a sum which is payable for the support of minor children of such husband. In case any such periodic payment is less than the amount specified in the decree or written instrument, for the purpose of applying the preceding sentence, such payment, to the extent of such sum payable for such support, shall be considered a payment for such support. Installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument shall not be considered periodic payments for the purposes of this subsection; except that an installment payment shall be considered a periodic payment for the purposes of this subsection if such principal sum, by the terms of the decree or instrument, may be or is to be paid within a period ending more than 10 years from the date of such decree or instrument, but only to the extent that such installment payment for the taxable year of the wife (or if more than one such installment payment for such taxable year is received during such taxable year, the aggregate of such installment payments) does not exceed 10 per centum of such principal sum. For the purposes of the preceding sentence, the portion of a payment of the principal sum which is allocable to a period after the taxable year of the wife in which it is received shall be considered an installment payment for the taxable year in which it is received. (In cases where such periodic payments are attributable to property of an estate or property held in trust, see section 171(b).)

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(g) *Capital Losses.*—

(1) *Limitation.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

* * * * *

(u) [As added by Sec. 120(b) of the Revenue Act of 1942, *supra*] *Alimony, Etc., Payments.*—In the case of a husband described in section 22(k), amounts includible under section 22(k) in the gross income of his wife, payment of which is made within the husband's taxable year. If the amount of any such payment is, under section 22(k) or section 171, stated to be not includible in such hus-

band's gross income, no deduction shall be allowed with respect to such payment under this subsection.

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l);

* * * * *

(5) [As amended by Sec. 150(a)(1) of the Revenue Act of 1942, *supra*] *Long-term Capital Loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such loss is taken into account in computing net income;

* * * * *

(b) [As amended by Sec. 150(c) of the Revenue Act of 1942, *supra*] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange

of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(d) [As amended by Sec. 150(c) of the Revenue Act of 1942, *supra*] *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

(2) *Other Taxpayers.*—In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer of $1,000, whichever is smaller. For purposes of this paragraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets.

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.)

☆ U. S. GOVERNMENT PRINTING OFFICE: 1954 300862 1360